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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

At Richmond, MARCH 20, 1998

APPLICATION OF

PO RIVER WATER & SEWER COMPANY

CASE NO. PUE950091

For a rate increase pursuant
to Virginia Code § 56-265.13:1 et seq.

FINAL ORDER

On September 15, 1995, Po River Water and Sewer Company (“Po River” or the “Company”) notified its customers of a proposed increase in rates for water and sewer services rendered on or after November 1, 1995.¹ Po River stated its intention to include Indian Acres Club of Thornburg, Inc. (“IACT”) as a separate customer class in accordance with the Commission’s directive in its final order in the Company’s 1992 rate proceeding.²

In response, IACT challenged the Commission’s authority to determine IACT’s status as a customer. This challenge recently culminated in the Supreme Court of Virginia rendering an opinion in Po River Water and Sewer Co. v. Indian Acres Club of Thornburg, Inc., et. al, Record No. 970050, slip op. at 5-6 (Jan. 9, 1998), petition for rehearing denied (Feb. 27, 1998), that

¹ By Orders dated October 31, 1995 and December 4, 1995, the Commission established a hearing, suspended the rates through November 30, 1995 and allowed the Company to put its proposed rates and charges into effect on an interim basis, subject to refund (with interest), effective December 1, 1995.

² See State Corporation Commission v. Po River Water & Sewer Company, Case No. PUE920039, 1994 SCC Ann. Rept. 310.

confirmed the Commission's authority in this regard. The Court held that the Commission has sole jurisdiction over the matter of establishing customer classes for the purpose of determining rates. Thus, the only issues that remain in this proceeding are the revenue requirement and proposed rates.

Po River provides water service to 6,230 individual lots and all of IACT's common area facilities, including three swimming pools, a clubhouse and restaurant, a recreation center, administrative offices, a store, a laundromat, a carwash and 42 comfort stations. In addition, the Company provides sewer service to the majority of its customers by means of "dump stations" which are scattered throughout the campground and provides direct service to 82 individual lots located in Glen 11.³ Po River provides year-round water and sewer service to 25 of the 42 comfort stations and 18 of the dump stations are provided with "frost-free hydrants" for year-round service. The Company provides service to individual lot owners from mid-April through mid-November.

In its application, Po River proposed two alternate rate structures, depending on whether IACT is determined to be a separate customer. Both of the Company's rate structures are based on a revenue requirement of \$490,000. In the event that IACT would not be deemed a customer, Po River proposed to charge individual lot owners a rate of \$43.75 per quarter.⁴ Alternatively, the Company proposed to charge IACT a flat quarterly rate of \$85,750 for service provided to its common area facilities and amenities; this would, in turn, lower the individual lot owners' rate to

³ Lot owners empty the sewage tanks from their recreational vehicles at the dump stations; the sewage is pumped into the Company's waste treatment plant where it is processed.

⁴ Po River calculated the quarterly rate of \$43.75 for individual lot owners by dividing the \$490,000 by 2,800 billing determinants and then dividing that figure by four to arrive at its proposed quarterly payments. Po River used 2,800 billing determinants because it asserts that is the number of paying individual lot owners.

\$13.13 per quarter.⁵ The Company has billed the individual lot owners a quarterly rate of \$43.75 and IACT \$85,750 per quarter. IACT has failed to pay its bills.

Po River's proposed rate structure is based on a water and sewer allocation study in which it separated its total cost of service into water and sewer components of 40% and 60%, respectively. The Company then estimated the total water consumption attributable to IACT and, after subtracting that amount from the total system usage (less a 2.5% "unaccounted for" water factor), arrived at a water consumption estimate for IACT of 27.84%. With respect to IACT's sewer usage, the Company estimated the usage attributable to the Glen 11 lot owners and subtracted that amount from the total system usage to arrive at an estimated usage allocation of 96.2% for IACT.

The Commission Staff contended that Po River's study was flawed in a number of ways. Specifically, Staff asserted that: (i) the study is based on only one month of usage and therefore is not representative; (ii) the limited information provided by the Company is inconsistent with the percentages used in the study; (iii) the Company's allocation of water and sewer into components of 40% and 60%, respectively, was based solely on the Company's judgment (i.e., there is no independent support for the figures); (iv) the estimate of IACT's total consumption is based on data collected at only five metered stations; (v) the study's assumption that all costs of providing water service should be allocated on the basis of an average day's consumption ignores certain expenses; and (vi) sewer usage attributable to the dump stations should not be assigned to IACT.

Staff found that the Company's proposed revenue requirement of \$490,000 is reasonable. It recommended an uncollectible rate of 30% be applied to the individual lot owners; the 30% is

⁵ The \$343,000 (the total revenue collected from IACT over a year) was subtracted from \$490,000 and that number (\$147,000) was divided by the 2,800 billing determinants and further divided by four to arrive at a quarterly rate of \$13.13.

the ratio of nonpaying customers to the total billed customers. Staff believes that the bad debt expense is consistent with the methodology approved in the 1992 rate case and recognizes that only 70% of the billed lot owners pay their bills.

Staff adjusted the usage factors for water to attribute 22.96% to IACT and 77.04% to individual lot owners, using usage data from the 12 month period of May, 1995 through April, 1996. Staff also reapportioned the sewer expenses. It contended that the Company overstated the sewer usage attributable to IACT because it assigned all of the dump stations to IACT. Staff believes that usage associated with the dump stations should be attributed to the individual lot owners since the dump stations serve the purpose of collecting sewage from the individual lot owners. Staff therefore assigned the usage attributable to the dump stations to the individual lot owners and apportioned the sewerage expenses in the same manner as water expenses; i.e., based on water consumption. Staff noted that water and sewer usage typically are closely correlated.

Staff stated that it did not have sufficient information upon which to develop an alternate cost allocation study and, instead, made several adjustments to Po River's study. Staff apportioned 20.39% of the Company's overall revenue requirement to IACT and 79.61% to the individual lot owners. Then, using 2,800 billing determinants, Staff calculated a quarterly rate of \$24,977.75 for IACT and a quarterly rate of \$34.83 for the individual lot owners.

With respect to the Company's proposed miscellaneous charges, Staff did not object to the customer deposit, reconnection charge, and certain additions and revisions to the Company's rules and regulations, with one exception as discussed in the Hearing Examiner's Report.

In addition, Staff made several recommendations regarding Po River's future cost of service studies. Staff recommended that: (i) the Company be directed to install meters on all 42

comfort stations; (ii) the Company be required to use at a minimum two years of data when analyzing customer consumption; (iii) the Company be directed to separate accounting and legal expenses, and any other expenses not associated with consumption, from its cost of service and assign them using an allocation methodology unrelated to consumption; and (iv) in the event that the Commission does not accept Staff's recommendation that sewer revenues be apportioned in the same manner as water revenues, the Company be directed to perform a cost of service study separating the Company's total costs into water and sewer components, using a cost of service methodology accepted by the American Water Works Association.

On June 27, 1997, the Hearing Examiner issued his Report in which he adopted Staff's recommendations, with the exception of Staff's recommendation regarding additional meters.⁶ Specifically, the Hearing Examiner recommended that Staff's proposed adjustments to the Company's expense associated with the installation of meters to IACT amenities and to the Company's management fees are reasonable and should be adopted. The Examiner found that a revenue requirement of \$490,000 is reasonable. The Hearing Examiner agreed with Staff that the Company should continue to bill 4,007 accounts, the number of accounts the Company actually has been billing since its 1992 rate case. He also agreed with Staff that to reduce the customer base "would punish those who continue to pay, not only by increasing their rates, but also by failing to provide an incentive for the Company to attempt to collect from those who currently refuse to pay." Hearing Examiner's Report at 8. The Examiner stated that the Company should "vigorously pursue delinquent customers." *Id.* He concluded that rates for lot owners should be determined using 2,800 billing determinants. The Examiner recommended that

⁶ See Hearing Examiner's Report at 14.

the IACT rate should be \$24,977.75 per quarter and the individual lot owners' rate should be \$34.83 per quarter, as recommended by Staff.

The Hearing Examiner also recommended that the Company and IACT should work together to improve the Company's billing and collections measures, and that Po River be directed to renew its collection efforts in local courts. The Hearing Examiner agreed with Staff's recommendation concerning the Company's proposed miscellaneous charges and revisions to its rules and regulations. Finally, the Hearing Examiner dismissed IACT's allegations that the system has major leaks and the Company should be directed to perform the maintenance necessary to correct the situation. The Examiner stated that "there is no indication that [Po River] is failing to provide adequate service to its customers" and "it would be inappropriate for the Commission to mandate repairs at this time."⁷

IACT takes a number of exceptions to the Hearing Examiner's findings and recommendations. Apart from its argument that IACT is not a customer of Po River, IACT contends that the Examiner's finding that rates should be calculated based on 2,800 paying customers is unjust and unreasonable. IACT argues that Po River's precipitous loss of paying customers over the past few years is due to the Company's "lack of competence in prosecuting collections cases and poor judgment in deciding to terminate all collection efforts." IACT Exceptions at 2. IACT also contends that Po River is not entitled to the full amount of its proposed rate increase because the Company's expenses are excessive. IACT asserts, for example, that the Company's failure to repair major leaks and maintain the distribution system has resulted in increased production and maintenance costs. IACT also asserts that Po River could

⁷ Id. at 15.

have curtailed its billing costs by accepting IACT's offer to be the agent for collection purposes, but that the Company has refused to take this action which "by its own admission, will reduce its costs of operations by \$70,000 annually." Id. at 14. Further, IACT argues that the rate of return recommended by the Hearing Examiner is excessive.

Po River also filed Comments on the Hearing Examiner's Report. The Company urges the Commission to adopt the rates proposed by the Company, rather than Staff's proposed rates. Po River maintains that IACT uses over 96% of the sewer services and that the individual lot owners use approximately 72% of the water service. The Company asserts that the usual assumption of a direct correlation between water and sewer use does not apply in IACT's case. Po River continues to argue that the per lot rate for the individual lot owners should be based on no more than 2,800 paying customers. The Company states that it should not be required to base its rates on 4,004 paying customers because that figure assumes over 1,200 more paying customers than is the actual case. Po River rebuts IACT's contention that the 4,004 number should be used because the actual lower paying customer base is due to the Company's incompetence in pursuing collection actions. The Company points out that IACT's argument is incredible since IACT itself had the Company enjoined from collecting its bills. Moreover, Po River states, cases concerning whether individual lot owners should be considered customers were still pending through the middle of 1995.

Po River also rejects IACT's allegation that the Company's water leakage rate is 56%, arguing that the Hearing Examiner correctly found that IACT's leakage rate methodology has too many inconsistencies to be accurate. With respect to lowering billing costs, Po River states that it, not IACT, initiated discussions regarding the possibility of IACT serving as a billing agent. Po

River further states that IACT, in its post hearing brief, appears to offer to perform only billing and collection services but not take on the responsibility of operating and maintaining the systems and, if that is the case, the Company is willing to work out an arrangement in this regard.

NOW upon consideration of the Company's application, the record herein, the June 27, 1997 Hearing Examiner's Report, the comments and exceptions thereto, and the applicable statutes and rules, the Commission is of the opinion and finds that the recommendations of the Hearing Examiner are reasonable, supported by the record, and should be adopted, with certain modifications discussed below.

First, we find the Company's allocation study and supporting data to be woefully inadequate. Therefore, we will direct the Company in its next rate proceeding to incorporate into its allocation study Staff's recommendations that the Company: (i) use a minimum of two years of data when analyzing its customers' consumption; (ii) separate accounting and legal expenses, and any other expenses not associated with consumption, from its cost of service and assign these items using an allocation methodology unrelated to consumption; and (iii) perform a cost of service study separating the Company's total costs into water and sewer components, using a cost of service methodology accepted by the American Water Works Association.

Second, because the Company's cost of service study and the supporting materials are inadequate, it is unclear whether the various costs should be treated as proposed by the Company or recommended by our Staff. Nevertheless, we are required to decide the appropriate level of rates and other rate-related issues based on the record that has been established. Therefore, we will accept the Company's cost allocation between water and sewer into components of 40% and 60%, respectively. We find that the Company's assignment of sewer expenses to IACT may be

appropriate but that further study, including a detailed analysis and supporting data, is required before a final determination can be made. For this case we will allocate half of the 96.2% (or 48.1%) to IACT. The remainder of sewer allocation, or 51.9%, will be assigned to the individual lot owners. We direct that this allocation issue be further analyzed by the Company and Staff in the next rate proceeding.

With respect to the allocation of water expenses, we find that Staff's recommendation that 20.39% of the water revenues be assigned to IACT is reasonable. Staff's number is slightly lower than the number proposed by the Company because Staff allocated a portion of the Company's water revenues based on the number of bills that will be issued to IACT and the individual lot owners.⁸ In other words, Staff's calculation reflects the fact that some portion of the Company's expenses are not associated with usage. Thus, the individual lot owners will be assigned the remainder of the water expense allocation, or 79.61%.

We will not assume a 30% uncollectible rate for the individual lot owners that was recommended by the Hearing Examiner. We are aware that Po River's situation is somewhat unusual since it provides service to individuals in a campground and to an association that is composed of the same individuals. However, the owners of Po River assumed certain risks in purchasing this utility, including the risk of locating its customers and collecting payments from them. Po River's paying customers are not responsible for the Company's decline in its paying customer base and should not be saddled with unreasonable costs stemming from that problem. In other words, the paying customers should not be put in the position of being *de facto*

⁸ Staff estimated that the Company's customer accounting and legal expenses account for 12.31% of its total operating expenses and, based on that determination, apportioned 11.21% of the revenue requirement based on the number of bills that will be issued to IACT and the individual lot owners during the pro forma period. See May 23, 1996 Staff Testimony at 10.

guarantors of the Company. Moreover, the Commission cannot require a dwindling number of customers to subsidize the Company by allowing it an extraordinarily high uncollectible expense.⁹

Instead of using 2,800 billing determinants for lot owners' rates, we find that the use of 3,400 billing determinants is appropriate. Based on a \$490,000 revenue requirement and 3,400 billing determinants, the quarterly rate for individual lot owners will be \$22.69 and the quarterly rate for IACT will be \$45,345, prospectively, to become effective April 30, 1998, for service rendered on or after May 1, 1998.

We further find that to require the quarterly rate of \$45,345 for IACT for the interim period is not appropriate and that the new rates should be phased in. Accordingly, for the period from December 1, 1995, through April 30, 1998, the quarterly rate for IACT will be \$22,672.50 and the quarterly rate for individual lot owners will be \$29.36.

Further, we will require Po River in its next rate proceeding to propose a third rate schedule which would be applicable to the Glen 11 lot owners that would reflect the costs associated with their individual sewer connections. We also direct the Company and IACT to work together to develop improved billing and collection measures, as suggested by the Hearing Examiner, and to report to the Commission's Division of Energy Regulation on the results of this collaboration.

Accordingly, IT IS ORDERED that:

(1) The findings and recommendations of the June 27, 1997 Hearing Examiner's Report are hereby adopted, with the modifications discussed in the body of this Order.

⁹ We note that, based on the total number of lots, 6,230, even using 3,400 billing determinants, the Company will, in effect, be allowed an uncollectible rate of approximately 45%.

(2) The rates for the period from December 1, 1995, through April 30, 1998, shall be \$22,672.50 per quarter for IACT and \$29.36 per quarter for the individual lot owners.

(3) The rates effective April 30, 1998, for services rendered on or after May 1, 1998, shall be \$22.69 per quarter for individual lot owners and \$45,345 per quarter for IACT.

(4) On or before April 10, 1998, Po River shall file with the Division of Energy Regulation revised tariffs which are consistent with the findings made herein, effective for service rendered on or after May 1, 1998.

(5) On or before December 31, 1998, Po River shall complete the refund, with interest as directed below, of all revenues collected from the application of the interim rates which became effective for service rendered during the period December 1, 1995, through April 30, 1998, to the extent that such rates exceed the rates established in ordering paragraph number 2.

(6) Interest upon the ordered refunds shall be computed from the date payment of each quarterly bill was due during the interim period until the date refunds are made, at an average prime rate for each calendar quarter. The applicable average prime rate for each calendar quarter shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin, or in the Federal Reserve's Selected Interest Rates (Statistical Release G.13), for the three months of the preceding calendar quarter.

(7) The interest required to be paid shall be compounded quarterly.

(8) The refunds ordered in paragraph (5) above shall be accomplished by credit to the appropriate customer's account for current customers who made payments under the interim rates beginning with the first billing cycle after the date of this Order. Any outstanding credit remaining as of December 1, 1998, shall be refunded in full on or before December 31, 1998. Refunds to

former customers shall be made by a check to the last known address of such customers when the refund amount is \$1.00 or more. Po River may offset the credit or refund to the extent no dispute exists regarding the outstanding balances of its current customers, or for customer who are no longer on its system. To the extent that outstanding balances of such customers are disputed, no offset shall be permitted for the disputed portion. Po River may retain refunds owed to former customers when such refund is less than \$1.00. However, the Company shall prepare and maintain a list detailing each of the former accounts for which refunds are less than \$1.00, and in the event such former customers request refunds, same shall be made promptly. All unclaimed refunds shall be handled in accordance with Virginia Code § 55-210.6:2.

(9) On or before February 1, 1999, Po River shall file with the Division of Energy Regulation a document showing that all refunds have been lawfully made pursuant to this Order and itemizing the costs of the refund and accounts charged. Such itemization of costs shall include, inter alia, computer costs, the personnel hours, associated salaries, and costs for verifying and correcting the refund methodology and developing the computer program.

(9) Po River shall bear all costs of the refund directed in this Order.

(10) There being nothing further to be done herein, this matter shall be dismissed from the Commission's files for ended causes.